

Report
of the
Examination of
Pacific Indemnity Company
Milwaukee, Wisconsin
As of December 31, 2001

TABLE OF CONTENTS

	Page
I. INTRODUCTION	1
II. HISTORY AND PLAN OF OPERATION.....	4
III. MANAGEMENT AND CONTROL.....	8
IV. AFFILIATED COMPANIES	10
V. REINSURANCE.....	16
VI. FINANCIAL DATA.....	25
VII. SUMMARY OF EXAMINATION RESULTS.....	34
VIII. CONCLUSION	41
IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS	42
X. ACKNOWLEDGMENT	43



State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Jim Doyle, Governor
Jorge Gomez, Commissioner

Wisconsin.gov

January 30, 2003

121 East Wilson Street • P.O. Box 7873
Madison, Wisconsin 53707-7873
Phone: (608) 266-3585 • Fax: (608) 266-9935
E-Mail: information@oci.state.wi.us
Web Address: oci.wi.gov

Honorable Alfred W. Gross
Chairman, Financial Condition (E)
Committee, NAIC
Secretary, Southeastern Zone, NAIC
Commissioner of Insurance
Commonwealth of Virginia
Tyler Building
Post Office Box 1157
Richmond, Virginia 23218

Honorable Susan F. Cogswell
Secretary, Northeastern Zone, NAIC
Commissioner of Insurance
State of Connecticut
153 Market St. 7th Floor
Hartford, Connecticut 06103

Honorable Sally McCarty
Secretary, Midwestern Zone, NAIC
Commissioner of Insurance
State of Indiana
311 West Washington St., Suite 300
Indianapolis, Indiana 46204-2787

Honorable John Morrison
Secretary, Western Zone, NAIC
Commissioner of Insurance
State of Montana
840 Helena Avenue
Helena, Montana 59601

Honorable Jorge Gomez
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53702

Commissioners:

In accordance with your instructions, a compliance examination has been made of
the affairs and financial condition of:

PACIFIC INDEMNITY COMPANY
Milwaukee, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The California Insurance Department conducted the previous examination of the company in 1997 as of December 31, 1996. The current examination covered the intervening period ending December 31, 2001, and included a review of such 2002 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

- History
- Management and Control
- Corporate Records
- Conflict of Interest
- Fidelity Bonds and Other Insurance
- Employees' Welfare and Pension Plans
- Territory and Plan of Operations
- Affiliated Companies
- Growth of Company
- Reinsurance
- Financial Statements
- Accounts and Records
- Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

Independent Actuary's Review

Independent actuaries were engaged under a contract with the Indiana Department of Insurance. They reviewed the adequacy of the company's loss reserves and loss adjustment expense reserves. The results of their work were reported to the examiner-in-charge. As deemed appropriate, reference is made in this report to the actuaries' conclusion.

II. HISTORY AND PLAN OF OPERATION

The Pacific Indemnity Company (hereinafter also “Pacific Indemnity” or the “company”) was incorporated pursuant to the laws of the state of California on January 16, 1926, and commenced business on February 5, 1926. Effective December 31, 1997, the company redomesticated to the State of Wisconsin.

The Chubb Corporation (a New Jersey holding company) through an exchange of shares acquired financial control of the company and its respective subsidiaries, effective November 15, 1967. The holding company on December 5, 1969, transferred ownership to its wholly owned subsidiary, Federal Insurance Company (hereinafter also “Federal”), which is one of the more prominent insurance carriers in the United States.

The Chubb Corporation ranks among the largest insurance organizations in the United States and is recognized as an industry leader in providing specialized insurance coverages for select commercial customer groups as well as unique products and services for the upscale personal lines market. At the time of examination, the Chubb Corporation employed approximately 12,600 persons in 135 offices worldwide.

The Chubb Corporation owns directly or through subsidiaries fourteen domestic property/casualty companies (hereinafter also the “Chubb Group”). Ten of these companies, including Pacific Indemnity, participate in an inter-company pooling arrangement. In addition, the other four members that comprise the Chubb Group cede 100% of their business to one of the ten direct pool participants. For additional information related to affiliates see the section of this report titled “Affiliated Companies.” Additional information related to the inter-company pooling arrangement and other significant reinsurance programs are discussed further in the section of this report titled “Reinsurance.”

Effective January 1, 1998, Federal replaced Chubb & Son Inc. (a New York Corporation) as the manager of the Chubb Group. As manager, Federal manages the insurance business and provides financial advisory services to the other group members. Federal is headquartered in Warren, New Jersey, and is the primary employer for the Chubb Group. Other

members of the Chubb Group generally have no employees of their own and ultimately rely on Federal for the staff essential to run day to day operations.

Federal initially pays the majority of expenses for the Chubb Group. Expenses other than federal taxes, management services, and certain underwriting services for unique, unusual and special hazards, are allocated in accordance with the affiliated pooling reinsurance agreement according to each insurer's participation in premiums and losses. Federal tax allocations are established in accordance with a written consolidated federal income tax agreement. Reimbursement for management service expenses is paid to Federal Insurance Company in accordance with a contract effective January 1, 1998. Pacific Indemnity is also provided certain underwriting services by Chubb Custom Market, Inc., and Chubb & Son, Inc., both affiliates. Inter-company balances with affiliates are created in the ordinary course of business with settlements generally not less than quarterly. Written agreements with affiliates are further described in the section of this report titled "Affiliated Companies."

In the United States and Canada, the Chubb Group is represented by approximately 5,000 independent agents and accepts business on a regular basis from an estimated 1,000 insurance brokers. Additional business is produced through participation in certain underwriting pools and syndicates.

In 2001, the company wrote business in all 51 jurisdictions in which it was licensed.

The distribution of direct premiums written in 2001 by state:

New York	\$99,306,937	23%
Massachusetts	38,508,959	9
California	33,775,306	8
Pennsylvania	27,016,475	6
Ohio	23,104,591	5
Florida	19,818,234	5
Wisconsin	6,496,828	1
All others *	<u>187,277,158</u>	<u>43</u>
	<u>\$435,304,488</u>	<u>100%</u>

* Includes \$144,985 of direct premiums written in foreign countries.

As of the examination date, the company was licensed in the District of Columbia, and all 50 states.

In the state of Wisconsin, the company is licensed to transact the following lines of business as defined by s. Ins 6.75 (2), Wis. Adm. Code:

- (a) Fire, Inland Marine, and Other Property
- (b) Ocean Marine
- (c) Disability
- (d) Liability and Incidental Medical Expense
- (e) Automobile and Aircraft
- (f) Fidelity
- (g) Surety
- (J) Credit
- (k) Worker's Compensation
- (l) Legal Expense
- (m) Credit Unemployment
- (n) Miscellaneous Insurance

The following table is a summary of the net insurance premiums written by the company in 2001. The growth of the company is discussed in the Financial Data section of this report.

Line of Business	Direct Premium	Reinsurance Assumed	Reinsurance Ceded	Net Premium
Fire	\$ 296,004	\$ 2,595,571	\$ 1,353,683	\$ 1,537,892
Allied lines	109,061	1,086,463	207,941	987,583
Homeowners multiple peril	161,543,215	140,748,411	146,638,586	155,653,040
Commercial multiple peril	32,402,624	172,365,377	65,568,829	139,199,172
Ocean marine	120	13,944,363	2,455,988	11,488,495
Inland marine	50,756,501	54,324,026	47,864,256	57,216,271
Medical malpractice - occurrence		(418,097)	(180,135)	(237,962)
Medical malpractice - claims made		13,177,241	4,920,018	8,257,223
Earthquake	3,019,542	3,603,959	2,834,657	3,788,844
Group accident and health	260,062	29,894,212	860,707	29,293,567
Other accident and health	16,734	56,664	13,889	59,509
Workers' compensation	83,790,339	65,431,734	80,433,878	68,788,195
Other liability - occurrence	20,863,490	100,781,379	36,217,551	85,427,318
Other liability - claims made	82,094	236,023,963	39,119,911	196,986,146
Products liability - occurrence	5,161,747	19,263,477	6,348,646	18,076,578
Products liability - claims made	82,936	313,739	73,340	323,335
Private passenger auto liability	24,242,493	40,564,572	28,433,094	36,373,971
Commercial auto liability	3,409,637	28,218,181	7,542,114	24,085,704
Auto physical damage	29,945,085	54,667,489	35,080,650	49,531,924
Fidelity	513,792	24,886,200	3,435,083	21,964,909
Surety	9,958,751	19,781,498	13,371,752	16,368,497
Burglary and theft	18,118	6,637,592	521,901	6,133,809
Boiler and machinery	8,707,143	14,195,044	9,674,671	13,227,516
Credit	125,000	371,882	260,014	236,868
Reinsurance—non-proportional assumed property		21,899,594	4,128,374	17,771,220
Reinsurance—non-proportional assumed liability		6,256,523	2,331,311	3,925,212
Reinsurance—non-proportional assumed financial lines		149,688		149,688
Total All Lines	<u>\$435,304,488</u>	<u>\$1,070,820,745</u>	<u>\$539,510,709</u>	<u>\$966,614,524</u>

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of eight members. Directors are elected annually to serve one-year terms. Officers are elected at the board's annual meeting. Members of the company's board of directors may also be members of other boards of directors in the Chubb Group. The Directors receive no compensation specific to their service on the board because all are employees of the holding company system.

Currently, the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
James A. Darling Mequon, Wisconsin	Senior Vice President Chubb & Son, a Division Of Federal Insurance Company	2003
Henry G. Gulick Middletown, New Jersey	Vice President & Secretary – The Chubb Corp.	2003
David G. Hartman New Providence, New Jersey	Senior Vice President & Chief Actuary - Chubb & Son, a Division of Federal Insurance Company	2003
Thomas F. Motamed Ho-Ho-Kus, New Jersey	Executive Vice President The Chubb Corporation	2003
Dean R. O'Hare Far Hills, New Jersey	Chairman & CEO The Chubb Corporation	2003
Michael O'Reilly Franklin Lakes, New Jersey	Executive Vice President The Chubb Corporation	2003
Henry B. Schram Mendham, New Jersey	Senior Vice President The Chubb Corporation	2003
Phillip J. Sempier Little Egg Harbor, New Jersey	Vice President & Treasurer – The Chubb Corp.	2003

Officers of the Company

The officers appointed by the board of directors and serving at the time of this examination are listed below. Listed compensation is Pacific Indemnity's allocated portion (approximately 16.3%) of the total gross earnings for services rendered to the Chubb holding company system as a whole.

Name	Position	2001 Compensation
Dean R. O'Hare*	Chairman	\$208,641
Thomas F. Motamed	President	167,829
John J. Degnan	Senior Vice President	152,936
Malcolm B. Burton	Vice President	43,094
Terrence B. Cavanaugh	Vice President	**
James A. Darling	Vice President	**
David G. Hartman	Vice President & Chief Actuary	60,599
Henry G. Gulick	Vice President & Corporate Secretary	18,195
Walter P. Guzzo	Vice President	47,961
Charles M. Luchs	Vice President	97,682
Amelia C. Lynch	Vice President	28,293
Robert A. Marzocchi	Vice President	29,801
Joseph McVicar	Vice President	12,317
Micheal O'Reilly	Vice President	107,844
Nancy D. Pate-Nelson	Vice President	26,717
Marjorie D. Raines	Vice President	53,956
Frank E. Robertson	Vice President	30,409
Philip J. Sempier	Vice President & Treasurer	20,935
Roger D. Trachsel	Vice President	29,857

* Replaced by John Finnegan on December 1, 2002

** Newly elected officer in 2002.

Committees of the Board

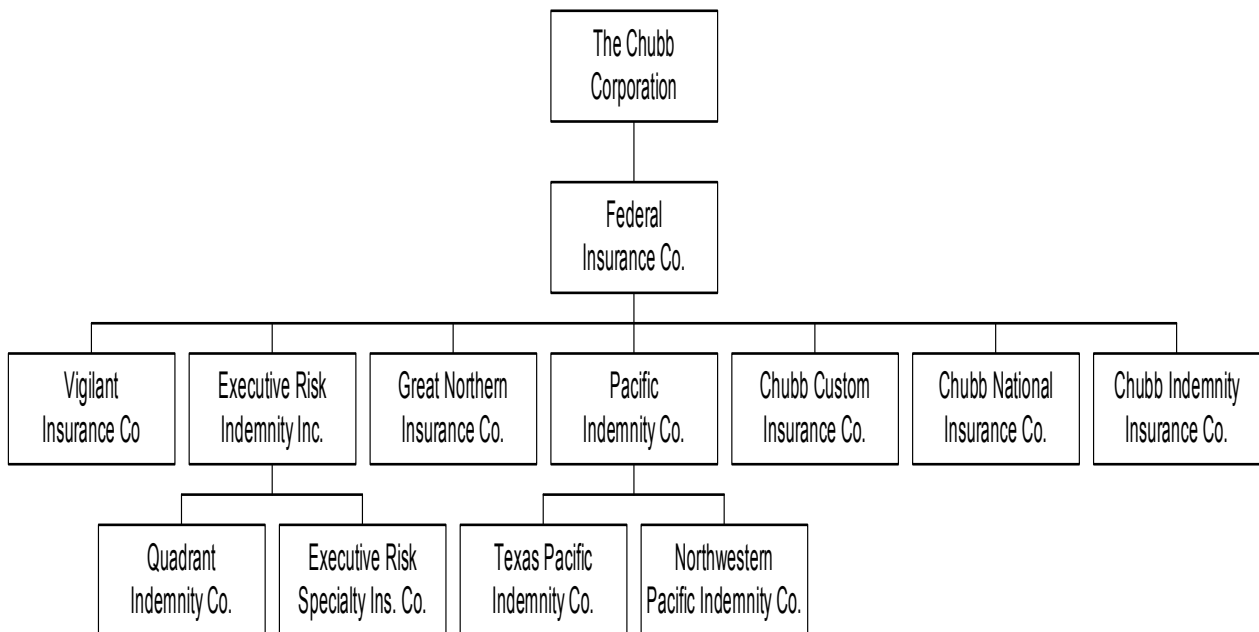
The company's bylaws allow for the formation of certain committees by the board of directors, however the bylaws do not require this formation and at this time there are no committees.

IV. AFFILIATED COMPANIES

Pacific Indemnity is a member of a holding company system ultimately controlled by The Chubb Corporation, a New Jersey Corporation. Due to the sheer enormity and worldwide dispersal of the corporate interests of The Chubb Corporation, this report will confine its discussion to affiliated insurance companies with direct interest in the inter-company pooling arrangement or direct insurance subsidiaries of Pacific Indemnity. Additional information related to the inter-company pooling arrangement and other significant reinsurance programs are discussed further in the section of this report titled "Reinsurance."

The following chart depicts the organizational structure of the ten direct pool participants and the two direct subsidiaries of Pacific Indemnity:

**Organizational Chart
As of December 31, 2001**



Succession of Control

The Chubb Corporation

The Chubb Corporation, a New Jersey holding company, ranks among the largest property and casualty organizations in the United States. It was incorporated as a business corporation under the laws of the State of New Jersey. Its registered shares (CB) are listed on the

New York Stock Exchange. The group employs approximately 12,600 persons, serving customers from 135 offices worldwide. As of December 31, 2001, the Annual Report indicated assets of \$29,449 million, liabilities of \$22,924 million, shareholders equity of \$6,525 million and net income of \$112 million on a consolidated basis. Net income in 2001 includes a net after tax loss of \$420 million related to the events of 9\11.

Federal Insurance Company

Federal Insurance Company (hereinafter also “Federal”) was organized under the laws of the State of New Jersey on February 15, 1901, and commenced business on March 2, 1901. On March 23, 1990, it was redomesticated to the State of Indiana. Federal is the primary employer for the Chubb Group. Other members of the Chubb Group generally have no employees of their own and ultimately rely on Federal for the staff essential to run day to day operations. Federal is headquartered in Warren, New Jersey, and maintains an office in Indianapolis, Indiana. Federal holds licenses and writes business in all 50 states, the District of Columbia, and several foreign countries. Federal has a 68% net retention in the affiliated pooling arrangement. The 2001 statutory annual statement reported assets of \$13,420.3 million, liabilities of \$9,894 million, policyholders’ surplus of \$3,526.3 million, and a net loss of \$18.6 million.

Subsidiaries of Federal Insurance Company

Vigilant Insurance Company

Vigilant Insurance Company (hereinafter also “Vigilant”) was incorporated on July 17, 1939, under the laws of New York as the Reserve Insurance Company. It was organized to write general fire and marine business and began operations on October 18, 1939. The present name was adopted on May 1, 1941. Vigilant writes business in all 53 U.S. jurisdictions in which it is licensed and has a 0.5% participation in the affiliated pooling arrangement. The 2001 statutory annual statement reported assets of \$247.9 million, liabilities of \$181.2 million, policyholders’ surplus of \$66.7 million, and net income of \$12.6 million.

Executive Risk Indemnity Inc.

Executive Risk Indemnity Inc. (hereinafter also “Executive Risk”) was organized under the laws of the State of Delaware on September 23, 1977, as the American Excess

Insurance Company, and commenced business on January 1, 1978. The present name was adopted on January 27, 1995. On July 19, 1999, The Chubb Corporation acquired Executive Risk Inc. (the company's ultimate parent at the time) and its subsidiaries, including Executive Risk. Executive Risk writes in all 51 U.S. jurisdictions in which it is licensed. Effective January 1, 2000, Executive Risk became a participant in the affiliated pooling arrangement with an 8% participation. The 2001 statutory annual statement reported assets of \$1,473.4 million, liabilities of \$1,151.7 million, policyholders' surplus of \$321.7 million, and net income of \$10.8 million.

Great Northern Insurance Company

Great Northern Insurance Company (hereinafter also "Great Northern") was incorporated on August 1, 1952, under the laws of Minnesota to become the successor to Underwriters at Lloyds of Minneapolis (organized in 1918). Great Northern writes business in all 51 U.S. jurisdictions in which it is licensed and has a 4% participation in the affiliated pooling arrangement. The 2001 statutory annual statement reported assets of \$847.0 million, liabilities of \$703.4 million, policyholders' surplus of \$143.5 million, and a net loss of \$6.6 million.

Chubb Custom Insurance Company

Chubb Custom Insurance Company (hereinafter also "Chubb Custom") was organized under the laws of Delaware on October 3, 1980 and commenced business on December 26, 1980. Chubb Custom writes business on an admitted basis in both U.S. jurisdictions in which it is licensed and on a surplus lines basis in the other 48 states and the District of Columbia. Chubb Custom has a 0.5% participation in the affiliated pooling arrangement. The 2001 statutory annual statement reported assets of \$137.1 million, liabilities of \$95.2 million, policyholders' surplus of \$41.9 million, and net income of \$5.2 million.

Chubb National Insurance Company

Chubb National Insurance Company (hereinafter also "Chubb National") was organized under the laws of Indiana on March 23, 1993 and commenced business on December 14, 1993. Chubb National writes business in 9 of the 49 U.S. jurisdictions in which it is licensed and has a 0.5% participation in the affiliated pooling arrangement. The 2001 statutory

annual statement reported assets of \$92.8 million, liabilities of \$70.5 million, policyholders' surplus of \$22.3 million, and net income of \$3.7 million.

Chubb Indemnity Insurance Company

Chubb Indemnity Insurance Company (hereinafter also "Chubb Indemnity") was organized under the laws of New York on November 3, 1922, as Sun Indemnity Company of New York. Federal Insurance Company purchased the company on February 3, 1994, and the present name was adopted. Chubb Indemnity writes business in all 51 U.S. jurisdictions in which it is licensed and has a 0.5% participation in the affiliated pooling arrangement. The 2001 statutory annual statement reported assets of \$116.3 million, liabilities of \$96.1 million, policyholders' surplus of \$20.2 million, and net income of \$3.6 million.

Subsidiaries of Executive Risk Indemnity Inc.

Quadrant Indemnity Company

Quadrant Indemnity Company (hereinafter also "Quadrant") was organized under the laws of Connecticut on April 21, 1997, as Vulcan Indemnity Inc. The name was changed to the current title prior to commencing business on September 17, 1997. On July 19, 1999, the Chubb Corporation acquired Executive Risk Inc. (the company's ultimate parent at the time) and its subsidiaries, including Quadrant. Quadrant writes in 20 of the 40 U.S. jurisdictions in which it is licensed. Effective January 1, 2000, Quadrant became a participant in the affiliated pooling arrangement with a 0.5% participation. The 2001 statutory annual statement reported assets of \$92.4 million, liabilities of \$69.7 million, policyholders' surplus of \$22.7 million, and net income of \$2.4 million.

Executive Risk Specialty Insurance Company

Executive Risk Specialty Insurance Company (hereinafter "Executive Specialty") was organized under the laws of Connecticut on October 30, 1991, as Executive Re Specialty Insurance Company and commenced business on December 31, 1991. Its current title was adopted on February 27, 1995. On July 19, 1999, The Chubb Corporation acquired Executive Risk, Inc., (the company's ultimate parent at the time) and its subsidiaries, including Executive Specialty. Executive Specialty writes business on an admitted basis in Connecticut, the only state

in which it is licensed, and on a surplus lines basis in all other U.S. jurisdictions. Effective January 1, 2000, Executive Specialty became a participant in the affiliated pooling arrangement with a 0.5% participation. The 2001 statutory annual statement reported assets of \$116.1 million, liabilities of \$86.5 million, policyholders' surplus of \$29.6 million, and net income of \$0.4 million.

Subsidiaries of Pacific Indemnity Company

Texas Pacific Indemnity Company

Texas Pacific Indemnity Company (hereinafter also "Texas Pacific") was organized under the laws of Texas on February 14, 1961, and commenced business on February 17, 1961. Texas Pacific is only licensed in Texas and Arkansas and writes predominately in Texas. The company cedes 100% of its business to its direct parent Pacific Indemnity. The 2001 statutory annual statement reported assets of \$13.1 million, liabilities of \$3.0 million, policyholders' surplus of \$10.1 million, and net income of \$0.9 million.

Northwestern Pacific Indemnity Company

Northwestern Pacific Indemnity Company (hereinafter also "Northwestern Pacific") was organized under the laws of Oregon on February 14, 1963 and commenced business on March 1, 1963. Northwestern Pacific is licensed in 7 U.S. jurisdictions and writes most of its business in Oregon and California. The company cedes 100% of its business to its direct parent Pacific Indemnity. The 2001 statutory annual statement reported assets of \$40.8 million, liabilities of \$6.8 million, policyholders' surplus of \$34.0 million, and a net income of \$3.1 million.

Written Agreements with Affiliates

As previously noted, while Federal is the primary employer amongst the insurance subsidiaries of the Chubb Group, consequential services are provided by employees of certain other affiliates, including but not limited to Chubb Custom Market, Inc. and Chubb & Son, Inc. In addition to common staffing and management control by certain affiliates, Pacific Indemnity's relationship to its affiliates is effective by various written agreements. Reinsurance agreements are described in the "Reinsurance" Section of this report. A brief summary of the other agreements follows.

Management Agreement with Federal Insurance Company

Effective January 1, 1998, Federal Insurance Company replaced Chubb & Son Inc. as the manager of the Chubb Group. In this capacity, Federal manages the insurance business and provides financial advisory services to members of the group, including Pacific Indemnity. Federal is reimbursed for all expenses associated with providing these services at cost. In addition, Federal is entitled to receive periodic reasonable advances that are settled as soon as practicable after the close of each calendar year. This agreement may be terminated at the end of any calendar year by either party giving the other 9 months prior written notice.

Service Agreements with Downstream Subsidiaries

Texas Pacific and Northwestern Pacific have service agreements with Pacific Indemnity, each company's direct parent, appointing Pacific Indemnity as agent to provide all services with respect to their operations.

Underwriting Service Agreement

Pacific Indemnity and Northwestern Pacific have entered into an agreement with Chubb Custom Market, Inc. and Chubb & Son, Inc., (Illinois), to receive underwriting services for unique, unusual and special hazard risks. This agreement may be terminated at the end of any calendar year by either party giving the other 9 months prior written notice.

Consolidated Federal Income Tax Agreement

Pacific Indemnity is party to a consolidated federal tax agreement with certain affiliates, whereby it files its federal income tax on a consolidated basis with The Chubb Corporation. Under this agreement, those wholly owned property and casualty insurance subsidiaries with taxable income are allocated a current provision or refund based on the ratio of their taxable income to the total taxable income of those companies having taxable income.

V. REINSURANCE

The companies' reinsurance treaties in force at the time of the examination are summarized below. The contracts contained the proper insolvency provisions. Unless otherwise noted, the summaries reflect terms in force at the time of the examination.

Affiliated Property and Casualty Pooling Agreement

The Chubb group of companies maintains an inter-company reinsurance pool, involving ten of the companies in the group. The pool covers all lines of business with the exception of foreign business and aircraft (all perils). Pool participants are Federal Insurance Company; Pacific Indemnity Company; Executive Risk Indemnity Company; Great Northern Insurance Company; Vigilant Insurance Company; Chubb Custom Insurance Company; Chubb National Insurance Company; Chubb Indemnity Insurance Company; Quadrant Indemnity Company; and Executive Risk Specialty Insurance Company. In addition to the ten direct pool participants, Texas Pacific Indemnity Company and Northwestern Pacific Indemnity Company cede 100% of their business to their parent, Pacific Indemnity Company; Chubb Lloyds Insurance Company of Texas cedes 100% to Great Northern Insurance Company; and Chubb Insurance Company of New Jersey cedes 100% to Federal Insurance Company. This business is then combined with the assuming company's own direct written business before cession to the pool.

The Chubb pool operates differently from a traditional U.S. pooling arrangement. In the Chubb pool, each participating company retains a designated percentage of its own business, and cedes the remainder of its business directly to each of the other pool companies at each company's pool percentage, for each risk. Therefore, each participating company assumes a designated percentage of all other pool participants' business. To illustrate, Pacific Indemnity, which has a 17% share of the pool, cedes 83% of its business to the other nine pool participants. Pacific Indemnity also directly assumes 17% of the subject business of each of the remaining nine pool participants. The pooling agreement contains a proper insolvency clause.

Federal Insurance Company (Federal) is the manager of the insurance businesses of the Chubb Group, and manages the reinsurance pool in that capacity. All direct premiums are collected by Federal employees, and all expenses and claims are initially paid by Federal employees, through Federal's bank accounts, on behalf of the other members of the pool. There is no management fee paid to Federal. Pooling accounts are settled through inter-company balances, and transactions are required to be settled quarterly under the pooling agreement. In the settlement of balances, each party to the agreement has the right to offset amounts payable to and receivable from any other party.

The Chubb Group purchases reinsurance on a combined group basis and apportions the cost among each participating insurer in proportion to subject premium writings, which generally approximate each company's contributory exposure to reinsured limits. Each of the insurers in the Chubb pool are direct co-parties to the ceded reinsurance agreements. Reinsurance is purchased for each major class of business written. Cessions to reinsurers are generally arranged through a reinsurance intermediaries. Additional terms of the pool as of December 31, 2001, are outlined below:

Effective: January 1, 1994, continuous, as restated January 1, 2000

Participation:	12/31/01
Federal Insurance Company	68.0%
Pacific Indemnity Company	17.0%
Executive Risk Indemnity Insurance Company	8.0%
Great Northern Insurance Company	4.0%
Vigilant Insurance Company	0.5%
Chubb Custom Insurance Company	0.5%
Chubb National Insurance Company	0.5%
Chubb Indemnity Insurance Company	0.5%
Quadrant Indemnity Company	0.5%
Executive Risk Specialty Insurance Company	0.5%

Lines Covered: All lines except foreign business and aircraft (all perils)

Items Included: Gross written premium, ultimate net loss and all related expenses

Termination: Until canceled by agreement of the parties, or with 60 days' written notice by any party.

Affiliated Assuming Contracts:

1. Cedant: Texas Pacific Indemnity Company
Reinsurer: Pacific Indemnity Company
Effective: March 9, 1961, continuous to present
Lines Covered: All lines
Retention: None
Coverage: 100% of incurred losses and loss expenses
Premium: 100% of gross written premium on all policies
2. Cedant: Northwestern Pacific Indemnity Company
Reinsurer: Pacific Indemnity Company
Effective: January 1, 1995, continuous to present
Lines Covered: All lines
Retention: None
Coverage: 100% of incurred losses and loss expenses
Premium: 100% of gross written premium on all policies

Non-Affiliated Ceding Contracts: (A graphic representation follows this section)

1. Type: Casualty Excess of Loss
Cedants: Federal Ins Co; Vigilant Ins Co; Great Northern Ins Co; Chubb Ins Co of New Jersey; Chubb Indemnity Ins Co; Chubb National Ins Co; Pacific Indemnity Co; Executive Risk Indemnity Co; Executive Risk Specialty Ins Co; Quadrant Indemnity Co; and other affiliated companies
Reinsurers: American Reinsurance Corp; ERC Frankona Rueckversicherungs; General Reinsurance Corp; Continental Casualty Co; Liberty Mutual Ins Co; Lumbermens Mutual Ins Co; NAC Reinsurance Corp; Odyssey Reinsurance Corp; Swiss Re America Corp; Berkley Ins Co; The Toa-Re Ins Co of America; Transatlantic Reinsurance Co; GE Reinsurance; New Jersey Re-Insurance Corp; PMA Capital Insurance Co.; Gerling Global Reinsurance Corp of America; Trenwick America Reinsurance Corp; QBE Reinsurance; Assicurazioni Generali SPA; St. Paul Fire & Marine Insurance Co.; Zurich Reinsurance North America, Inc.; Hannover Ruckversicherungs; Various Lloyd's syndicates
Effective: January 1, 2001
Termination: December 31, 2001

Lines Covered: All casualty lines

Coverage:

	<u>First Excess</u>	<u>Second Excess</u>	<u>Third Excess</u>
Retention	\$25,000,000	\$50,000,000	\$100,000,000
Limit	25,000,000	50,000,000	50,000,000
Aggregate Limit	100,000,000	none	none

Premium: Net Earned Premium times a factor, with required minimum premium. Deposit premiums are required and must be paid in quarterly installments on January 1, April 1, July 1 and October 1

	<u>First Excess*</u>	<u>Second Excess</u>	<u>Third Excess</u>
Premium Factor	0.192%	0.137%	0.076%
Minimum Premium	\$5,620,000	\$4,010,000	\$2,224,000
Deposit Premium	\$5,620,000	\$4,010,000	\$2,224,000

*Risks involving a single insured with policy limits greater than \$25M require deposit premium of \$13,680,000; to be adjusted against 70% of net written premium within 90 days following expiration of the policy

2. Type: Property Per Risk Excess of Loss

Cedants: Federal Insurance Co; Vigilant Ins Co; Great Northern Ins Co; Chubb Ins Co of New Jersey; Chubb Indemnity Ins Co; Chubb National Ins Co; Pacific Indemnity Co; Executive Risk Indemnity Co; Executive Risk Specialty Ins Co; Quadrant Indemnity Co; and other affiliated companies

Reinsurers: American Re; Employers Re; General Re; Swiss Re; American AG Re; Folksamerica; GE Reins Co; QBE Reins Corp; Liberty Mutual Ins Co; NAC Re; NJ Re Ins; Partner Re; St. Paul Fire; TOA Re Ins; XL Mid-Ocean Re; Hannover Ruckversicherungs; SPS Re; Copenhagen; Terra Nova (London); Continental; EMP Mutual; Erie Ins Exchange; Farmers Mutual; Gerling Global Re; Hartford Re; Mapfre Re; Republic West; Swiss Re America; CX Re Ltd (formerly CNA Re Ltd); QBE Intl Ins; The General of Berne; various Lloyd's syndicates

Effective: April 1, 2001

Termination: March 31, 2002

Lines Covered: All commercial property business

Coverage:

	<u>First Excess</u>	<u>Second Excess</u>	<u>Third Excess</u>
Retention	\$10,000,000	\$30,000,000	\$65,000,000
Limit	20,000,000	35,000,000	85,000,000
Aggregate Limit*	none	none	none

First excess layer has buffer retention of 75% of the first \$15M excess of \$25M

*Limits exist with respect to earthquake, windstorm and riot perils

Premium: Gross Net Earned Premium Income times a factor, with required minimum premium. Deposit premiums are required and must be paid in quarterly installments on April 1, July 1, October 1, and January 1.

	<u>First Excess</u>	<u>Second Excess</u>	<u>Third Excess</u>
Premium Factor	5.3199%	0.5724%	0.4444%
Minimum Prem.	\$44,942,222	\$4,835,555	\$3,754,666
Deposit Prem.	\$56,177,778	\$6,044,444	\$4,693,333

First excess layer also requires option premium of \$6,500,000 for three options to reduce retention to \$5M; and option premium of \$15,285,000 for four options to reduce retention to \$2.5M.

Commission: Ceding commission of 32.5% of gross premiums, not including option premiums

3. Type: Commercial Contingent Excess of Loss

Cedants: Federal Ins Co; Vigilant Ins Co; Great Northern Ins Co; Chubb Ins Co of New Jersey; Chubb Indemnity Ins Co; Chubb National Ins Co; Pacific Indemnity Co; Executive Risk Indemnity Co; Executive Risk Specialty Ins Co; Quadrant Indemnity Co; and other affiliated companies

Reinsurers: Various

Effective: April 1, 2001

Termination: March 31, 2002

Lines Covered: All commercial property business

Coverage: Retention 20,000,000
Limit 85,000,000
Aggregate Limit 85,000,000

Premium: Flat premium of \$1,500,000; payable in quarterly installments

4. Type: Property Catastrophe Excess of Loss

Cedants: Federal Insurance Co; Vigilant Ins Co; Great Northern Ins Co; Chubb Ins Co of New Jersey; Chubb Indemnity Ins Co; Chubb National Ins Co; Pacific Indemnity Co; Executive Risk Indemnity Co; Executive Risk Specialty Ins Co; Quadrant Indemnity Co; and other affiliated companies

Reinsurers: Swiss Re; General Re; American Agricultural Ins; Erie Ins Exchange; Farm Bureau Mutual; Farmers Mutual Hail; Folksamerica; Insurance Corp of Hannover; Liberty Mutual Ins Co; New Jersey Re; St. Paul Re; IPC Re Ltd.; Partners Re; XL Mid-Ocean Re; Bayerische Ruck; Central Re; La Mutuelle; SPS Re; Copenhagen Re; Wurttembergische Versicherung AG; Employers Re; Continental Casualty; EMP Mutual; GE Reins Corp; Gerling Global Re; Hartford Re; Mapfre Re; NAC Re; Odyssey Reins Corp; PMA Re; PXRE Re; Republic West; St. Paul Fire; State Auto Mutual; TOA Re Ins; Transatlantic Re; ACE Tempest Re; LaSalle Re Ltd; Renaissance Re; XL Re Ltd; Europa Rueck; Hannover Ruck; Sirius Intl; Folksam International Co; CX Re Ltd (formerly CNA Re Ltd.); GE Frankona Re; QBE Re; Scor Re; Inter-Ocean Re; The General of Berne; Nissan Fire & Marine; ALEA London; various Lloyd's syndicates

Effective: April 1, 2001

Termination: March 31, 2002

Lines Covered: All property business

Coverage:

	<u>First Excess</u>	<u>Second Excess</u>	<u>Third Excess</u>
Retention	\$100,000,000	\$175,000,000	\$300,000,000
Limit*	75,000,000	125,000,000	150,000,000
Aggregate Limit	150,000,000	250,000,000	300,000,000
Placement %	46%	90%	90%

*Company retains 10% of covered losses in addition to base retention

Premium: Gross Net Earned Premium Income times a factor, with required minimum premium. Deposit premiums are required and must be paid in quarterly installments on April 1, July 1, October 1, and January 1

	<u>First Excess</u>	<u>Second Excess</u>	<u>Third Excess</u>
Premium Factor	0.874%	0.973%	0.758%
Minimum Prem.	\$12,800,000	\$14,250,000	\$11,100,000
Deposit Prem.	\$16,000,000	\$17,812,500	\$13,875,000

5. Type: Personal Accident Catastrophe Per Risk Excess of Loss

Cedants: Federal Insurance Co; Vigilant Ins Co; Great Northern Ins Co; Chubb Ins Co of New Jersey; Chubb Indemnity Ins Co; Chubb National Ins Co; Pacific Indemnity Co; Executive Risk Indemnity Co; Executive Risk Specialty Ins Co; Quadrant Indemnity Co; and other affiliated companies

Reinsurers: Various

Effective: January 1, 2001

Termination: December 31, 2001

Lines Covered: All personal accident business, including war and terrorism perils

Coverage: \$4,000,000 excess of \$1,000,000 base retention
Buffer retention of \$5,000,000; aggregate limit of \$10,000,000

Premium: Gross Net Earned Premium Income times a factor of 1.55%
Minimum and deposit premium of \$1,326,000, payable in semi-annual installments

6. Type: Personal Accident Catastrophe Excess of Loss

Cedants: Federal Insurance Co; Vigilant Ins Co; Great Northern Ins Co; Chubb Ins Co of New Jersey; Chubb Indemnity Ins Co; Chubb National Ins Co; Pacific Indemnity Co; Executive Risk Indemnity Co; Executive Risk Specialty Ins Co; Quadrant Indemnity Co; and other affiliated companies

Reinsurers: American United Life Ins Co; Clarica Life Ins Co; Sydney Reins Corp; AIG Europe (UK) Ltd.; Wurttembergische Versicherung; Reliastar Ins Group (UK); Canada Life Assurance Co; Reliastar Life Ins Co; American National Ins Co; Manulife Reins Corp; Transatlantic Reins Co; various Lloyd's syndicates

Effective: January 1, 2001

Termination: December 31, 2001

Lines Covered: All personal accident business, including war and terrorism perils

Coverage:

	<u>First Excess</u>	<u>Second Excess</u>	<u>Third Excess</u>	<u>Fourth Excess</u>	<u>Fifth Excess</u>
Retention	\$5,000,000	\$10,000,000	\$20,000,000	\$50,000,000	\$150,000,000
Limit	5,000,000	10,000,000	30,000,000	100,000,000	100,000,000
Aggr. Limit	15,000,000	30,000,000	90,000,000	300,000,000	300,000,000

Premium: Gross Net Earned Premium Income times a factor, with required minimum premium. Deposit premiums are required and must be paid in semi-annual installments on January 1 and July 1

	<u>First Excess</u>	<u>Second Excess*</u>	<u>Third Excess*</u>	<u>Fourth Excess*</u>	<u>Fifth Excess*</u>
Premium Factor	1.875%	0.58%	0.246%	0.21%	0.0364%
Minimum Prem	\$1,600,000	\$496,400	\$210,000	\$180,000	\$31,000
Deposit Premium	\$1,600,000	\$496,400	\$210,000	\$180,000	\$31,000

*Additional premiums are required for workers compensation business ceded.

7. Type: Surety Excess of Loss

Cedants: Federal Insurance Co; Vigilant Ins Co; Great Northern Ins Co; Chubb Ins Co of New Jersey; Chubb Indemnity Ins Co; Chubb National Ins Co; Pacific Indemnity Co; Executive Risk Indemnity Co; Executive Risk Specialty Ins Co; Quadrant Indemnity Co; and other affiliated companies

Reinsurers: General Re; Swiss Re; American Re; Everest Re; NAC Re; Signet Star Re; Hannover Ruck; Zurich Ins Co; St. Paul Re; Transatlantic Re; Gerling Global Re; Partner Re; Continental Casualty; Zurich Re; Sorema; QBE Ins Corp; Odyssey Re; Assicurazioni Generali SPA; Wurttembergische Versicherungs; QBE Ins & Reins (Europe); Scor Re; Hartford Fire; GE Reinsurance.

Effective: January 1, 2001

Termination: December 31, 2001

Lines Covered: All surety risks

Coverage:

	<u>First Excess</u>	<u>Second Excess</u>	<u>Third Excess</u>	<u>Fourth Excess</u>	<u>Fifth Excess</u>
Retention	\$10,000,000	\$25,000,000	\$60,000,000	\$80,000,000	\$100,000,000
Limit*	15,000,000	35,000,000	20,000,000	20,000,000	50,000,000
Aggregate Limit*	43,500,000	52,500,000	20,000,000	20,000,000	65,000,000

*Company retains 10% of covered losses in addition to base retention on all layers except fifth excess layer; fifth excess aggregate limit is a cumulative limit

Premium: Net Premium Written times a factor. The rate for the first excess layer below is minimum rate stipulated for the first excess layer; rate varies with the balance at the end of the quarter

	<u>First Excess</u>	<u>Second Excess</u>	<u>Third Excess</u>	<u>Fourth Excess</u>
Premium Rate	6.20%	6.00%	1.24%	0.73%

Fifth excess layer has a flat premium of \$1,711,111, payable in four quarterly installments

Non-Affiliated Ceding Contracts: Graphic Representation

CHUBB INSURANCE GROUP – 2001 REINSURANCE PROGRAM					
<i>millions</i>	Casualty	Property	Property Catastrophe	Personal Accident	Surety
\$450			\$150mm x/s \$300mm 90% placed		
\$300			\$125mm x/s \$175mm 90% placed		
\$250				\$100mm x/s \$150mm 100% placed	
\$175			\$75mm x/s \$100 mm 44% placed		
\$150	\$50mm x/s \$100mm 100% placed	\$85mm x/s \$65mm 100% placed		\$100mm x/s \$50mm 100% placed	\$50mm x/s \$100mm 80% placed
\$100	\$50mm x/s \$50 mm 100% placed		\$100mm Base retention		\$20mm x/s \$80mm 90% placed
\$80					\$20mm x/s \$60mm 90% placed
\$60		\$35mm x/s \$30mm 100% placed			\$35mm x/s \$25mm 90% placed
\$50	\$25mm x/s \$25mm 100% placed			\$30mm x/s \$20mm 100% placed	
\$30		\$20mm x/s \$10 mm 100% placed			
\$25	\$25mm Base retention				\$15mm x/s \$10mm 90% placed
\$20				\$10mm x/s \$10mm 100% placed	
\$10		\$10mm Base Retention		\$5mm x/s \$5mm 100% placed	\$10mm Base retention
\$5				\$4mm x/s \$1mm 100% placed \$1 mm base retention	

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported in the December 31, 2001, annual statement to the Commissioner of Insurance. Also included in this section are schedules that reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."

Pacific Indemnity Company
Assets
As of December 31, 2001

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	\$2,237,880,669	\$ 0	\$2,237,880,669
Stocks:			
Preferred stocks			
Common stocks	68,840,134		68,840,134
Cash	59,854,890		59,854,890
Other invested assets	65,661,184		65,661,184
Agents' balances or uncollected premiums:			
Premiums and agents' balances in course of collection	202,711,027	9,493,236	193,217,791
Premiums, agents' balances, and installments booked but deferred and not yet due	63,177,847		63,177,847
Accrued retrospective premiums	2,822,000	198,260	2,623,740
Amounts billed and receivable under deductible and service-only plans	6,958,267	185,228	6,773,039
Reinsurance recoverable on loss and adjustment payments	33,278,706		33,278,706
Federal and foreign income tax recoverable and interest thereon	139,699,879	80,175,910	59,523,969
Interest, dividends, and real estate income due and accrued	36,037,050		36,037,050
Receivable from parent, subsidiaries, and affiliates	21,639,464		21,639,464
Equities and deposits in pools and associations	9,297,839		9,297,839
Write-ins for other than invested assets			
Accounts Receivable - Securities	<u>7,025</u>	<u>7,025</u>	<u> </u>
Total Assets	<u>\$2,947,865,981</u>	<u>\$90,059,659</u>	<u>\$2,857,806,322</u>

Pacific Indemnity Company
Liabilities, Surplus, and Other Funds
As of December 31, 2001

Losses	\$1,260,467,108
Reinsurance payable on paid loss and loss adjustment expenses	
Loss adjustment expenses	363,077,965
Commissions payable, contingent commissions, and other similar charges	17,418,455
Other expenses (excluding taxes, licenses, and fees)	16,968,050
Taxes, licenses, and fees (excluding federal and foreign income taxes)	8,322,298
Unearned premiums	514,045,243
Dividends declared and unpaid:	
Policyholders	12,341,999
Ceded reinsurance premiums payable (net of ceding commissions)	83,876,854
Funds held by company under reinsurance treaties	1,179,422
Amounts withheld or retained by company for account of others	1,456,379
Provision for reinsurance	20,623,747
Payable for securities	866
Write-ins for liabilities:	
Contingency reserve for municipal obligations	545,244
Accounts payable - sundry	<u>1,697</u>
 Total Liabilities	 2,300,325,327
 Common capital stock	 5,535,000
Gross paid in and contributed surplus	190,019,566
Unassigned funds (surplus)	<u>361,926,429</u>
 Surplus as Regards Policyholders	 <u>557,480,995</u>
 Total Liabilities and Surplus	 <u>\$2,857,806,322</u>

**Pacific Indemnity Company
Summary of Operations
For the Year 2001**

Underwriting Income

Premiums earned \$ 922,938,953

Deductions:

Losses incurred 637,424,627

Loss expenses incurred 128,520,810

Other underwriting expenses incurred 299,988,422

Write-ins for underwriting deductions:

Lad program expense 257,533

Total underwriting deductions 1,066,191,392

Net underwriting loss (143,252,439)

Investment Income

Net investment income earned 131,086,245

Net realized capital gains or (losses) 7,356,721

Net investment gain or (loss) 138,442,966

Other Income

Net gain or (loss) from agents' or premium balances charged off (1,438,240)

Finance and service charges not included in premiums

Write-ins for miscellaneous income:

Miscellaneous expense (13)

Total other income (1,438,253)

Net income (loss) before dividends to policyholders and

before federal and foreign income taxes (6,247,726)

Dividends to policyholders 4,845,706

Net income (loss) after dividends to policyholders but

before federal and foreign income taxes (11,093,432)

Federal and foreign income taxes incurred 15,141,332

Net Loss \$ (26,234,764)

Note:

The Chubb Group's results in 2001 were adversely affected by two large loss events. In the third quarter, the Chubb Group incurred net costs of \$594 million before tax, related to the September 11 attack in the United States. In the fourth quarter, the Group recognized net surety bond losses of \$220 million before tax, arising from the bankruptcy of Enron Corp. In connection with The Chubb Corporation's long-term capital strategy and the capital needs resulting from the two large loss events, Pacific Indemnity received a capital contribution of \$80 million during the fourth quarter of 2001.

Pacific Indemnity Company
Cash Flow
As of December 31, 2001

Premiums collected net of reinsurance	\$947,010,345	
Loss and loss adjustment expenses paid (net of salvage or subrogation)	648,094,053	
Underwriting expenses paid	299,608,543	
Other underwriting income (expenses)	<u>(4,035,884)</u>	
Cash from underwriting		\$ (4,728,135)
Investment income (net of investment expense)		130,831,810
Other income (expenses):		
Agents' balances charged off	(1,438,240)	
Net funds held under reinsurance treaties	226,000	
Net amount withheld or retained for account of others	(102,638)	
Write-ins for miscellaneous items:		
Equities & deposits in pools and associations	927,367	
Miscellaneous expense	<u>(13)</u>	
Total other income		(387,524)
Deduct:		
Dividends to policyholders paid	5,610,734	
Federal income taxes paid (recovered)	<u>17,906,414</u>	
Net cash from operations		\$102,199,003
Proceeds from investments sold, matured, or repaid:		
Bonds	514,778,283	
Stocks	29,139,934	
Other invested assets	19,341,461	
Miscellaneous proceeds	<u>2,895,557</u>	
Total investment proceeds		566,155,235
Cost of investments acquired (long-term only):		
Bonds	562,116,186	
Stocks	26,512,527	
Other invested assets	<u>21,381,709</u>	
Total investments acquired		<u>610,010,422</u>
Net cash from investments		(43,855,187)
Cash provided from financing and miscellaneous sources:		
Surplus notes, capital and surplus paid in	<u>80,000,000</u>	
Total		80,000,000
Cash applied for financing and miscellaneous uses:		
Dividends to stockholders paid	75,000,000	
Net transfers to affiliates	<u>5,310,679</u>	
Total		<u>80,310,679</u>
Net cash from financing and miscellaneous sources		<u>(310,679)</u>
Net change in cash and short-term investments		58,033,137

Reconciliation

Cash and short-term investments, December 31, 2000	<u>1,821,753</u>
Cash and short-term investments, December 31, 2001	<u>\$59,854,890</u>

Pacific Indemnity Company
Compulsory and Security Surplus Calculation
December 31, 2001

Assets		\$2,857,806,322	
Less liabilities		<u>2,300,325,327</u>	
Adjusted surplus			\$557,480,995
Annual premiums (less dividends to Policyholders):			
Individual accident and health	\$ 59,509		
Factor	<u>15%</u>		
Total			8,926
Group accident and health	29,293,567		
Factor	<u>10%</u>		
Total			2,929,357
Lines other than accident and health	932,415,742		
Factor	<u>20%</u>		
Total		<u>186,483,148</u>	
Compulsory surplus (subject to a minimum of \$2 million)			<u>189,421,431</u>
Compulsory surplus excess (or deficit)			<u>\$368,059,564</u>
Adjusted surplus (from above)			\$557,480,995
Security surplus: 112%			
(140% of compulsory surplus, factor reduced 1% for each \$33 million in premium written in excess of \$10 million, with a minimum factor of 110%)			<u>212,152,003</u>
Security surplus excess (or deficit)			<u>\$345,328,992</u>

Pacific Indemnity Company
Reconciliation and Analysis of Surplus
For the Five-Year Period Ending December 31, 2001

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	1997	1998	1999	2000	2001
Surplus, beginning of year	\$505,156,028	\$530,491,768	\$545,748,933	\$531,326,091	\$533,000,130
Net income	120,435,850	121,470,767	90,690,276	100,970,243	(26,234,764)
Net unrealized capital gains or (losses)	9,656,159	(6,306,501)	(3,050,962)	1,707,405	(2,685,949)
Change in net unrealized foreign exchange capital gains (losses)					(905,851)
Change in net deferred income tax					33,508,486
Change in non-admitted assets	(1,006,951)	(1,417,437)	(601,516)	(1,663,288)	(21,276,788)
Change in provision for reinsurance	(3,744,839)	1,514,815	(1,456,161)	664,299	(7,227,761)
Cumulative effect of changes in accounting principles					44,517,859
Surplus adjustments:					
Paid in					80,000,000
Dividends to stockholders	(100,000,000)	(100,000,000)	(100,000,000)	(100,000,000)	(75,000,000)
Write-ins for gains and (losses) in surplus:					
Change in contingency reserve for municipal obligations	(4,479)	(4,479)	(4,479)	(4,620)	(214,367)
Surplus, end of year	<u>\$530,491,768</u>	<u>\$545,748,933</u>	<u>\$531,326,091</u>	<u>\$533,000,130</u>	<u>\$557,480,995</u>

Pacific Indemnity Company
Insurance Regulatory Information System
For the Five-Year Period Ending December 31, 2001

The following is a summary of NAIC Insurance Regulatory Information System (IRIS) results for the period under examination. There were no exceptional ratios.

	Ratio	1997	1998	1999	2000	2001
#1	Gross Premium to Surplus	226%	233%	233%	263%	270%
#2	Net Premium to Surplus	149	150	152	169	173
#3	Change in Net Writings	8	3	-2	12	8
#4	Surplus Aid to Surplus	0	0	0	1	1
#5	Two-Year Overall Operating Ratio	82	82	87	87	92
#6	Investment Yield	6	5.7	5.8	5.7	5.6
#7	Change in Surplus	6	4	-2	2	5
#8	Liabilities to Liquid Assets	83	83	84	88	92
#9	Agents' Balances to Surplus	8	9	7	30	35
#10	One-Year Reserve Devel. to Surplus	-1	-6	-4	-7	-8
#11	Two-Year Reserve Devel. to Surplus	-3	-9	-19	-14	-21
#12	Estimated Current Reserve Def. To Surplus	-2	-8	-26	-12	-13

Growth of Pacific Indemnity Company

Year	Admitted Assets	Liabilities	Surplus As Regards Policyholders	Net Income (Loss)
1997	\$2,292,378,025	\$1,761,886,257	\$530,491,768	\$120,435,850
1998	2,398,734,017	1,852,985,084	545,748,933	121,470,767
1999	2,478,747,696	1,947,421,605	531,326,091	90,690,276
2000	2,574,766,223	2,041,766,093	533,000,130	100,970,243
2001	2,857,806,322	2,300,325,327	557,480,995	(26,234,764)

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss And LAE Ratio	Expense Ratio	Combined Ratio
1997	\$1,200,599,511	\$792,176,378	\$758,670,099	65.9%	30.2%	96.1%
1998	1,270,121,988	819,350,315	793,395,438	65.6	31.9	97.5
1999	1,238,737,022	806,272,003	808,780,123	73.2	31.7	104.9
2000	1,400,778,834	899,141,720	854,202,372	67.5	31.6	99.1
2001	1,506,125,233	966,614,524	922,938,953	83.0	31.2	114.2

Loss and LAE ratios were adversely impacted during 2001 as two significant events affected the Group's performance. The Chubb Group experienced net losses and loss expenses of \$625 million and net reinstatement premium revenue of \$30 million, related to the events of September 11 and incurred net surety bond losses of \$220 million related to Enron. Pacific Indemnity received a 17% share of these losses.

Reconciliation of Surplus per Examination

The following schedule is a reconciliation of surplus as regards policyholders between that reported by the company and as determined by this examination:

Surplus December 31, 2001, per Annual Statement			\$557,480,995
	Increase	Decrease	
Unpaid Losses	\$	<u>\$98,453,000</u>	
Net increase or (decrease)	<u>\$</u>	<u>\$98,453,000</u>	<u>(98,453,000)</u>
Surplus December 31, 2001, per Examination			<u>\$459,027,995</u>

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were no specific comments or recommendations in the previous examination report issued by the California Insurance Department.

Summary of Current Examination Results

Audit Premiums

Pacific Indemnity's 2001 statutory annual statement did not include an estimate for audit premium. According to Statements of Statutory Accounting Principles (SSAP), No. 53, paragraph 9, "Adjustments to the premium charged for changes in the level of exposure to insurance risk (e.g., audit premiums on workers' compensation policies) are generally determined based upon audits conducted after the policy has expired. Reporting entities shall estimate audit premiums, the amount generally referred to as earned but unbilled (EBUB) premium, and shall record the amounts as an adjustment to premium, either through written premium or as an adjustment to earned premium."

No adjustment to surplus is proposed due to lack of materiality. However, it is recommended that in future annual statements, the company properly estimate and report audit premium in accordance with the NAIC Accounting Practices and Procedures Manual.

Management and Control

The examiners reviewed the biographical information on the company's officers and directors filed with this office. It was determined that the company has not updated the information to reflect changes in these positions. It is recommended that the company maintain with this office current biographical information on its officers and directors in compliance with s. Ins. 6.52, Wis. Adm. Code.

Provisionally Exempt Securities

NAIC designations are the specific alphanumeric symbols in use by the NAIC Securities and Valuation Office (SVO) to denote a category of credit quality for certain securities held by insurers. These NAIC designations range from 1 to 6, with NAIC 1 being assigned to obligations exhibiting the highest quality and NAIC 6 being assigned to obligations that are in or near default. In general, an insurance company is provided a rating after filing the security with the SVO. However, securities that are rated and monitored by two or more acceptable Nationally Recognized Statistical Rating Organization (NRSRO)'s and are equivalent to NAIC designations

or 2, may be provisionally exempted (PE) for filing purposes. These securities are identified with the administrative symbol “PE” proceeding the NAIC designation.

Under the provisional exemption rules, outlined by the Purpose and Procedures Manual of the NAIC Securities Valuation Office, an insurer initially determines if a security is eligible for exemption based on a three part test; a ratings test, an issuer test, and an optionality test. For each provisionally exempt security, the insurer is required to maintain a record supporting its decision, including details of the terms of the security, documents verifying the security’s rating, and documents evidencing its continued monitoring of PE securities.

The examination revealed that Pacific Indemnity did not have written procedures related to PE securities and was unable to provide documentation supporting its decision to list securities as PE. It is recommended that the company develop and implement written procedures related to PE securities that includes maintaining a record supporting its decisions and evidencing its continued monitoring of the securities listed as PE.

Reinsurance Contracts

The examiners requested access to signed executed agreements to substantiate the relationship between the company and its various reinsurers. In a few instances the company was unable to locate a signed copy of the Interests and Liabilities endorsement for certain reinsurers. In these instances examiners were able to determine the validity of the reinsurance by other means. However, it is recommended that the company implement controls to ensure that signed executed reinsurance contracts are readily available for the company’s own interest in collecting reinsurance, as well as future examinations by this office.

Securities Lending Program

Pacific Indemnity has been participating in a securities lending program since 1999. The company has entered into an agreement with a bank to administer its securities lending program and to act as custodian for the collateral received. The examiners’ review of its security lending program noted that the company inappropriately considered securities loaned at year-end to be under its exclusive control. Accordingly, the company did not identify with an “LS” designation in the appropriate asset schedules nor did it disclose in the General Interrogatories in

accordance with the NAIC Annual Statement Instructions—Property and Casualty and Statements of Statutory Accounting Principles (SSAP), No. 18, paragraph 36.

The NAIC Annual Statement Instructions—Property and Casualty identifies “exclusive control,” as the exclusive right to dispose of the investment at will, without the necessity of making a substitution thereof. In accordance with the company’s Security Lending Agreement the company may instruct the bank to terminate any transaction in whole or in part by giving the bank written notice. Upon any such termination, the company is entitled to receive Equivalent Securities within one business day following the notice of recall. The examination determined that these equivalent securities would be a substitution of the originally loaned securities and concluded the company did not have exclusive control of loaned securities. It is recommended that in future annual statements, the company properly identify and disclose loaned securities in accordance with the NAIC Annual Statement Instructions—Property and Casualty.

Special Deposits

Pacific Indemnity assumes a small block of business from Chubb Insurance Company of Canada (hereinafter “Chubb of Canada”), an affiliate. The examiners’ noted that the Superintendent of Financial Institutions Canada held several bonds, owned by Pacific Indemnity, to secure Pacific Indemnity’s share of losses or liabilities arising from its reinsurance agreement with Chubb of Canada. According to the NAIC Annual Statement Instructions—Property and Casualty, these bonds should have been reported in Schedule E – Part 2, as special deposits, which are not for the benefit of all policyholders, claimants and creditors of the company. It is recommended that in future annual statements, the company properly identify special deposits in accordance with the NAIC Annual Statement Instructions—Property and Casualty.

Underwriting

As noted earlier, in the fourth quarter of 2001, the Group recognized net surety bond losses of \$220 million before tax, arising from the bankruptcy of Enron Corp. The company indicated that several underwriting staff members, associated with the Enron business acquired, had exceeded their underwriting authority and had not properly communicated information to

senior management summarizing these risks. These instances indicate that existing internal controls were not sufficient to detect or deter these violations. It is recommended that the company review its existing internal controls involving levels of authority for underwriting limits and requirements for obtaining additional reinsurance on a facultative basis, when appropriate, to deter similar instances from occurring in the future, and to assure that the company's actual underwriting exposure is consistent with management's directives.

Unpaid Losses

\$1,358,920,108

This liability represents the company's estimate of amounts payable on losses incurred on or prior to December 31, 2001, and remaining unpaid as of that date. As noted earlier, the Chubb Corporation owns directly or through subsidiaries fourteen domestic property/casualty companies (hereinafter also the "Chubb Group"). Ten of these companies, including Pacific Indemnity, participate in an inter-company pooling arrangement. In addition, the other four members that comprise the Chubb Group cede 100% of their business to one of the ten direct pool participants. For additional information related to affiliates see the section of this report titled "Affiliated Companies." Additional information related to the inter-company pooling arrangement and other significant reinsurance programs are discussed further in the section of this report titled "Reinsurance."

On October 30, 2002, The Chubb Corporation announced reserve strengthening of \$730 million gross, \$625 million net of reinsurance, for Asbestos and Environmental (hereinafter "A&E") reserves and represented that these reserve additions were the result of a newly created outside consultant's A&E reserve review. The Chubb Group's opining actuary, David G. Hartman, FCAS, MAAA, Senior Vice President and Chief Actuary, indicated that of the \$625 million net addition, \$110 million was due to environmental claims and \$515 million was the result of asbestos claims.

On January 2, 2003, it was announced that Chubb had settled the Enron-related surety bond claims at approximately 52 cents on the dollar. Because Chubb had recorded a reserve for the full amount of the claims at year-end 2001, the settlement resulted in a credit to

Chubb's 2002 earnings of about \$88 million pre-tax. This is a net reduction in the 2001 loss reserve for these claims.

On February 4, 2003, The Chubb Corporation announced that in the fourth quarter of 2002, the company strengthened its net asbestos loss reserves by \$75 million pre-tax to reflect a reduction in its estimate of reinsurance recoverable related to the asbestos reserve strengthening discussed above.

The aforementioned events were partially offset by redundancies on other lines that the examination took into consideration in making an adjustment in response to these circumstances. Accordingly, the examination made an adjustment of \$98.453 million, which represents Pacific Indemnity's 17% share of the net reserve strengthening of \$612 million due to the significant events noted above, offset by redundancies in other lines. This adjustment equals the one-year adverse development reported by the company in its 2002 Statutory Annual Statement. The adjustment reflecting the increase to net loss reserves and a decrease to surplus may be found in the "Reconciliation of Surplus per Examination" section of this report.

In connection with The Chubb Corporation's long-term capital strategy and the capital needs resulting from the reserve strengthening discussed above, Pacific Indemnity received a capital contribution of \$180 million during the fourth quarter of 2002.

Municipal Bond Contingency Reserve **\$545,244**

The company carried a contingency reserve of \$545,244 related to municipal bond obligations. The contingency reserve is established for the protection of policyholders covered by policies insuring municipal bonds against the effect of excessive losses occurring during adverse economic cycles. The contingency reserve is calculated based on earned premium on policies, and is maintained for 20 years. The company has reported the change in the contingency reserve as a direct charge or credit to surplus. Section Ins 3.08 (7) (b), Wis. Adm. Code, requires that the change in the contingency reserve shall be reported as a reduction of or a deduction from underwriting income. The amount of these changes has been immaterial, and does not affect reported surplus. However, it is recommended that the company comply with s. Ins 3.08, Wis.

Adm. Code, in reporting the change in contingency reserve, unless it obtains a permitted accounting practice to do otherwise.

Letters of Credit

The company secures reinsurance recoverables from unauthorized reinsurers through a variety of means, including letters of credit. The company had about \$90 million of letters of credit securing reserve credits at December 31, 2001. In general, each letter of credit names all members of the Chubb reinsurance pool as beneficiaries, not Pacific Indemnity alone. Section Ins 52.04 (4), Wis. Adm. Code, establishes the requirements for a letter of credit that allows the ceding insurer to take reserve credit for reinsurance ceded, which include "...subject to withdrawal solely by, and under the exclusive control of, the ceding insurer...". Since any member of the Chubb reinsurance pool may draw on the multiple beneficiary letters of credit, the letters of credit do not satisfy the requirement in the administrative rule.

This issue was identified as a potential problem when the company redomiciled to Wisconsin in 1997; an agreement was reached that this office would permit the company to take credit for the multiple beneficiary letters of credit until the issue could be evaluated during the next examination. Accordingly, this office has issued permitted accounting practice letters to the company for financial statements as of December 1997 through September 2003. No adjustment to surplus will be made related to the letters of credit, because of the permitted accounting practice letters. However, discussions on the issue during the examination have not demonstrated that the permitted accounting practice should be continued. Therefore, it is recommended that the company not take reserve credit for unauthorized reinsurance ceded that is secured by letters of credit that do not comply with ch. Ins 52, Wis. Adm. Code.

VIII. CONCLUSION

As noted earlier, the Chubb Group's results in 2001 were adversely affected by two large loss events. In the third quarter, the Chubb Group incurred net costs of \$594 million before tax, related to the September 11 attack in the United States. In the fourth quarter, the Group recognized net surety bond losses of \$220 million before tax, arising from the bankruptcy of Enron Corp. In connection with The Chubb Corporation's long-term capital strategy and the capital needs resulting from the two large loss events, Pacific Indemnity received a capital contribution of \$80 million during the fourth quarter of 2001.

Similarly, the Chubb Group's results in 2002 were negatively impacted by net reserve strengthening of \$625 million for A&E reserves during the third quarter. Pacific Indemnity again received a significant capital contribution (\$180 million) in the succeeding quarter to address its capital needs. While the examination made an adjustment of \$98.453 million, which represents Pacific Indemnity's share of the reserve strengthening reported by the company, The Chubb Corporation's commitment to its long-term business strategy and to the capital needs of its direct and indirect subsidiaries are acknowledged.

The examination resulted in nine recommendations, none of which were repeated from the previous examination, conducted by the California Insurance Department. The recommendations ranged from areas related to management's control, possible improvements of the company's control environment, and several financial reporting issues that were identified during the examination.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 35 - Audit Premiums—It is recommended that in future annual statements, the company properly estimate and report audit premium in accordance with the NAIC Accounting Practices and Procedures Manual.
2. Page 35 - Management and Control—It is recommended that the company maintain with this office current biographical information on its officers and directors in compliance with s. Ins. 6.52, Wis. Adm. Code.
3. Page 35 - Provisionally Exempt Securities—It is recommended that the company develop and implement written procedures related to PE securities that includes maintaining a record supporting its decisions and evidencing its continued monitoring of the securities listed as PE.
4. Page 36 - Reinsurance Contracts—It is recommended that the company implement controls to ensure that signed executed reinsurance contracts are readily available for the company's own interest in collecting reinsurance, as well as future examinations by this office.
5. Page 36 - Security Lending Program—It is recommended that in future annual statements, the company properly identify and disclose loaned securities in accordance with the NAIC Annual Statement Instructions—Property and Casualty.
6. Page 37 - Special Deposits—It is recommended that in future annual statements, the company properly identify special deposits in accordance with the NAIC Annual Statement Instructions—Property and Casualty.
7. Page 37 - Underwriting— It is recommended that the company review its existing internal controls involving levels of authority for underwriting limits and requirements for obtaining additional reinsurance on a facultative basis, when appropriate, to deter similar instances from occurring in the future, and to assure that the company's actual underwriting exposure is consistent with management's directives.
8. Page 39 - Municipal Bond Contingency Reserve—It is recommended that the company comply with s. Ins 3.08, Wis. Adm. Code, in reporting the change in contingency reserve, unless it obtains a permitted accounting practice to do otherwise.
9. Page 40 - Letters of Credit—It is recommended that the company not take reserve credit for unauthorized reinsurance ceded that is secured by letters of credit that do not comply with ch. Ins 52, Wis. Adm. Code.

X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Name	Title
Randy Milquet	Data Processing Audit Specialist
Sarah Salmon	Insurance Financial Examiner
Russell Lamb	Insurance Financial Examiner

Respectfully submitted,

Tim Vande Hey
Senior Insurance Financial Examiner
Examiner-in-Charge